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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 824

MRS. M. M. (W. I.) COOK ESTATE, TRUSTEES,
Appellants,

vs.

GEORGE H. SHEPPARD, AS COMPTROLLER OF THE STATE OF TEXAS, AND CHARLEY LOCKHART, AS STATE TREASURER OF TEXAS,
Appellees.

STATEMENT AS TO JURISDICTION.

This suit was instituted by appellants against the State officers named as appellees, to restrain the enforcement of the Texas Gross Production Tax Law of 1933,[1] as applied to royalty oil, and to collect from the State officials the amount of tax already exacted, on the ground that the law, both in terms and as applied to them, violates the obligation of their antecedent oil lease and oil sales contracts and deprives them of their property without due process, in violation of the obligation of contract and due process of law clauses of the State and Federal Constitutions. The law

[1] Its pertinent provisions are set out at the end of this statement.

was incidentally challenged, also, on the ground it violated other provisions of the State Constitution which it is not necessary to now outline.

Long before the enactment in question, appellants, as trustees, owned royalty under leases which granted the lessees the exclusive right to engage in the business of producing oil from the land covered thereby and required the lessees "to deliver to the credit of lessor, *free of cost,* • • • the equal one-eighth part of all oil produced and saved from the leased premises." Appellants had written contracts for the sale of their oil to the Humble Oil & Refining Company, by which the company agreed to pay them the full posted price of the oil, without deduction. Appellants are not and have never been in anywise engaged in the business of producing oil. Appellees admit these facts (R. 18, 30, 34).

At the time the aforesaid contracts were made the Texas law laid a gross production tax of two per cent of the value of all oil produced upon the producer alone (R. 38).

The law in question (H. B. 154, Acts 1933, 43rd Legislature p. 409, ch. 162, as amended Acts 1933, 43rd Legislature First Called Session p. 43, ch. 12, Vernons Annotated Texas Statutes 1925, Supp. Art. 7057-A) levies what is denominated "an occupation tax on oil produced within this State of two cents per barrel • • •. Said tax shall be computed upon the total barrels of oil produced • • • without any deductions." Under other provisions the tax is two per cent on each barrel if the value is in excess of $1.00 per barrel. While it is provided the tax "shall be a liability of the producer of oil and it shall be the duty of such producer to keep accurate records of all oil produced" and make reports to the Comptroller, it is further provided that the tax "*shall be borne ratably by all interested parties, including royalty interests*" and producers and purchasers are required to withhold from payments due interested parties, the proportionate tax due. By amendment made since this suit was

filed royalty owners are included in the definition of the term "producers" as used in the Act.*

The tax for the oil run in one month must be paid by the purchaser to the Comptroller, by the 25th of the month next after it is produced. Elaborate reports are required from the purchaser in connection with purchases of oil.

The Act provides that, "for the ocupation tax, penalties, and interest herein provided for the State shall have a prior and preferred lien on any leasehold interest, ownership of oil rights, or interest, including oil produced."

Since enactment of the law the Comptroller, purporting to act under the same, has required the Humble Company to deduct two cents per barrel from the price due appellants for their royalty oil, and pay it over to the State (R. 20-21). If appellants refuse to acquiesce in this arrangement their oil will be rejected by the purchaser (R. 36-38), and, under regulations of the Comptroller, they must pay the tax direct (R. 18).

We challenged this law in our petition (R. 9-11) in the State District Court on the ground it violated the obligation of contract and due process clauses of the Federal Constitution. We have alleged and maintained throughout:

1. A State cannot by a system of taxation directly impair the obligation of a private contract, *Murray* v. *Charleston*, 96 U. S. 44. The lease contract required the lessee to pay all expenses incident to engaging in the business of producing oil. A primary object of the law is to relieve our lessees of a part of the burden they voluntarily assumed in their leases. The State, under the law in question, requires the appellants to pay one-eighth of a tax imposed for the privilege owned exclusively by their lessee of engaging in the business of producing oil from the leases.

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*This provision of the amendment is set out at the end of this statement.

The purchaser, as agent of the State, deducts this part of the tax from appellants' remittance and sends it to the appellees. The substantial effect of the law is to give the lessee two cents or two percent more per barrel of oil than he is entitled to under the lease and prevent the lessor recovering the same. Such a law clearly impairs the due process and obligation of contract clauses of the Federal Constitution.

2. The law in question seeks to evade the provisions of the Texas Constitution which prohibit taxation of property except it be equal and uniform throughout the State, levied in the county where the property is situated, equalized by the County Commissioners Courts and limited in amount to 35 cents on the $100.00 valuation.[1] The fatal defect in the attempt to evade these constitutional inhibitions lies in the fact that the Legislature cannot, consistently with the due process clause of the Fourteenth Amendment to the Federal Constitution, arbitrarily declare appellants are engaged in the business of producing oil when they are admittedly not so engaged in fact. Occupation taxes or excises may be levied upon proper subjects, but the Legislative power cannot, consistently with due process, be exercised to arbitrarily create the conditions under which the liability shall exist, irrespective of the truth. To define as producers of oil, people who are not producers, in order to levy an otherwise unlawful tax upon them is the grossest sort of confiscation.

The Court of Civil Appeals held:

> "We construe the act to levy the tax against the various interest holders in the oil produced, including the producer and royalty owners,"

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[1]Under the Texas law royalty is real estate and taxable as other property as provided by the Constitution of Texas. *Sheffield* v. *Hogg*, 77 S. W. (2d) (Sup. Ct.) 1021.

"Whatever the character of the lease * * * there is always reserved a royalty interest * * * and manifestly this is the 'royalty interest' within the contemplation of the taxing act in suit, and against the owner of which the tax was levied."

"For the purpose of levying the gross production tax on the occupation or business of producing oil, the Legislature may validly declare the owners of royalty or other interests in the oil produced to be engaged in the occupation or business of producing oil." "The Legislature may reasonably impose the tax burden on those entitled to share in the gross receipts or profits of the oil enterprise * * * since under the lease * * * royalty owners may enforce its * * * covenants * * * to the end that their share of the receipts will increase and produce a greater royalty interest in the business." "The tax is not against the oil royalty. It is levied as a gross production tax on the business or occupation of producing oil." "The mere fact the producer is primarily liable * * * or * * * that the purchaser is required to collect the tax * * * does not give them any interest in the tax against the royalty interests. They (the producers) may have benefitted by the change of Legislative policy of imposing the tax ratably against the respective interest holders in the oil produced; but such Legislative tax policy did not impair any obligation of the lease contracts."

The holding of the Court of Civil Appeals that the lessor's right to enforce the lease "engages" him in the business of producing oil, is notable. We submit that the right to make the lessee produce and deliver the lessor's royalty oil is the very essence of the lessor's property right in the leased land. To tax that right, directly taxes the property itself. *Pollock* v. *Farmers Loan & Trust Company,* 157 U. S. 429, 158 U. S. 601. "It cannot be made an occupation or license tax by calling it so." *Dawson* v. *Kentucky Distilleries,* 255 U. S. 288.

The Court of Civil Appeals for the Third Supreme Judicial District at Austin, decided the case November 13, 1935 (R. 43). The Supreme Court of Texas denied a writ of error February 5, 1936 (R. 50), thereby approving the action of the Court of Civil Appeals. On February 26, 1936, it overruled a motion for rehearing of the application for writ of error, and thereupon returned the record to the Court of Civil Appeals (R. 76). The Court of Civil Appeals is the highest court of the State in which a decision could be had. The appeal to this Court was allowed by the Chief Justice of the Court of Civil Appeals, March 7, 1936.

State Procedure.

Finality of judgment Court of Civil Appeals, Vernons Tex. Civ. Stats., Art. 1857-8.

Jurisdiction Supreme Court on writ of error, Vernons Tex. Civ. Stats. Art. 1728 as amended.

Denial writ of error is approval judgment Court of Civil Appeals, Id. Art. 1728, and refusal to admit case to Supreme Court, Id. Art. 1750.

Jurisdiction This Court.

28 U. S. C. 344,
28 U. S. C. 861 a, b,
28 U. S. C. 350.

General Rule as to appeal from highest State court.
Matthews v. *Huwe*, 269 U. S. 262;

Texas cases here from Courts of Civil Appeals:
Sullivan v. *Texas*, 207 U. S. 416;
Bacon v. *Texas*, 164 U. S. 413;
St. L., S. F. & T. R. Co. v. *Seale*, 229 U. S. 156;
cf. *Bain Peanut Co.* v. *Pinson*, 282 U S. 499, 502;
Id. 34 S. W. (2d) 1090.

Court in which record remains is highest State court.
Hodges v. *Snyder*, 261 U. S. 600;
Rothschild v. *Knight*, 184 U. S. 334;
McDonald v. *Massachusetts*, 180 U. S. 311.

The challenged decision is not sustainable on any ground independent of the Federal questions which were decided adversely to appellants and which control the case. *Lynch* v. *New York*, 293 U. S. 52.

It is respectfully submitted that this Court has jurisdiction to hear the appeal.

Respectfully submitted,

WILLIAM R. WATKINS,
Attorney for Appellants.

APPENDIX.

The Daniel Production and Occupation Tax Law.

(Approved May 22, 1933.)

H. B. No. 154

SEC. 2. (1) There is hereby levied an occupation tax on oil produced within this State of two (2) cents per barrel of forty-two (42) standard gallons. Said tax shall be computed upon the total barrels of oil produced * * *. The occupation tax therein levied on oil shall be two per cent (2%) of the market value of said oil whenever the market value thereof is in excess of one dollar ($1) per barrel. * * *

(2) The tax hereby levied shall be a liability of the producer of oil.

(3) The purchaser of oil shall pay the tax on all oil purchased and deduct tax so paid from payment due producer or other interest holder, making such payments so deducted to the Comptroller of Public Accounts by legal tender or cashier's check payable to the State Treasurer.

Provided, that if oil produced is not sold during the month in which produced, then said producer shall pay the tax at the same rate and in the manner as if said oil were sold.

(6) The tax herein levied shall be borne ratably by all interested parties, including royalty interests; and producers and/or purchasers of oil are hereby authorized and required to withhold from any payments due interested parties the proportionate tax due.

SEC. 6. For the occupation tax, penalties, and interest herein provided for, the State shall have a prior and preferred lien on any leasehold interest, ownership of the oil rights, or interest, including oil produced and oil runs owned by the person owing any tax herein, and in addition thereto such lien shall include equipment, tools, tanks, and

all other implements used on said lease from which oil is produced.

Oil Taxes with Penalties for Evasion.

(Approved May 30, 1935.)

H. B. No. 89

"SEC. 1 (1). For the purpose of this Act 'producer' shall mean any person owning, controlling, managing or leasing any oil well and/or any person who produces in any manner any oil by taking it from the earth or waters in this State, and shall include any person owning any royalty or other interest in any oil or its value, whether produced by him, or by some other person on his behalf, either by lease, contract or otherwise.

"(9). 'Royalty owners' shall mean and include all persons owning any mineral rights under any producing leasehold within this State, other than the working interest, which working interest is that of the person having the management and operation of the well.

"(16). If the oil produced by said producer is not sold during the month in which it is produced, then said producer shall pay the tax at the same rate and in the same manner as if said oil were sold during said month. In such case, however, the working interest operator may pay such tax and deduct it from the interest of the other interest holders."